No. 92-1304

In The

Supreme Court of the United States

October Term, 1992

JERRY WOOLUM,

Petitioner,

vs.

BANK ONE, LEXINGTON, NA,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

RESPONDENT'S BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether a debtor's grossly reckless disregard for the veracity of his materially false financial statements constitutes an "intent to deceive" under Section 523(a)(2)(B)(iv) of the Bankruptcy Code for purposes of denying the discharge of debts obtained by use of the financial statements?

2. Whether the bankruptcy court's finding, after hearing all testimony and reviewing all documentary evidence, that a creditor reasonably relied on a debtor's materially false financial statements when extending credit to the debtor is reviewable under the clearly erroneous standard or *de novo?*

PARTIES TO THE PROCEEDINGS

Bank One, Lexington, NA, the respondent herein, was the appellant in the proceeding below. Jerry Woolum, the petitioner herein, was the appellee in the proceeding below.

Bank One, Lexington, NA is a wholly owned subsidiary of Banc One Corporation.

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RESPONDENT'S BRIEF IN OPPOSITION

OPINIONS BELOW

The opinion and judgment of the United States Court of Appeals for the Sixth Circuit reversing the decision of the district court are reproduced in petitioner's appendix (A[p]1a - A[p]12a)[1] and the opinion is reported as *In re Woolum*, 979 F.2d 71 (6th Cir. 1992).

1. Reference to the appendix of the Petition for Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit shall be made as (A[p] __a).

The unreported memorandum opinion and order of the United States District Court for the Eastern District of Kentucky are reproduced in petitioner's appendix (A[p]12a - A[p]23a).

The unreported order, judgment, and findings of fact and conclusions of law of the United States Bankruptcy Court for the Eastern District of Kentucky are reproduced in petitioner's appendix (A[p]24a - A[p]34a).

STATUTORY PROVISIONS INVOLVED

1. Section 523(a) of Title 11 of the United States Code provides:

> (a) A discharge under section 727, 1141, 1228(a), 1228(b) or 1328(b) of this title does not discharge an individual debtor from any debt —
>
> * * *
>
> (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by —
>
> (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;
>
> (B) use of a statement in writing —
>
> (i) that is materially false;
>
> (ii) respecting the debtor's or an insider's financial condition;

> (iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and
>
> (iv) that the debtor caused to be made or published with intent to deceive;
>
> . . . .

2. Rule 8013 of the Federal Rules of Bankruptcy Procedure provides:

> On an appeal the district court or bankruptcy appellate panel may affirm, modify, or reverse a bankruptcy judge's judgment, order, or decree or remand with instructions for further proceedings. Findings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the bankruptcy court to judge the credibility of the witnesses.

STATEMENT OF THE CASE

The proceedings below arose out of an adversary action commenced by respondent Bank One, Lexington, NA ("Bank One") against petitioner Jerry Woolum ("Dr. Woolum") in Dr. Woolum's voluntary Chapter 7 bankruptcy proceeding. Bank One brought the action to bar the discharge of Dr. Woolum's outstanding indebtedness to Bank One under 11 U.S.C. § 523(a)(2)(B). The parties stipulated that Dr. Woolum's financial statements were materially false and were given with respect to his financial condition, thereby satisfying two of the four elements of § 523(a)(2)(B). Following an evidentiary hearing at which Dr.

Woolum and Bank One loan officer, Linda Rumpke ("Rumpke") testified, the bankruptcy court found that Dr. Woolum acted in a grossly reckless manner by failing to list substantial liabilities on his financial statements and that Bank One reasonably relied on Dr. Woolum's financial statements when making loans to Dr. Woolum. Thus the bankruptcy court found that the two remaining elements of § 523(a)(2)(B) had been satisfied and held that Dr. Woolum's indebtedness to Bank One was nondischargeable.

The bankruptcy court's decision rested on its careful analysis of the factual matters revealed during the hearing and the inferences it drew therefrom. Such matters included the historical relationship between Dr. Woolum and Bank One, Dr. Woolum's extensive investment and real estate development experience, Bank One's ordinary and customary procedures in reviewing requests for loans, Rumpke's actual review of Dr. Woolum's credit bureau report, tax returns and financial statements, the substantial amount of Dr. Woolum's undisclosed liabilities, the litigation related to those liabilities and the standard procedures followed by Bank One and other banks when responding to garnishments against individuals that have no accounts with the bank. The nature and complexity of the many factual issues in this case is significant because it illuminates the proper role of the bankruptcy court in actions brought to deny discharge of debts under § 523(a)(2) and the correctness of the opinion below. Although petitioner omits many of these facts from his statement of the case, the opinion below contains a concise statement (A[p]2a - A[p]3a) which is incorporated herein by reference for the sake of brevity. The additional factual references contained throughout the opinion below (A[p]4a - A[p]11a) are also indicative of the factually intensive nature of this and other nondischargeability actions.[2]

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2. The petitioner's statement of the case contains a misstatement of fact which could bear on the importance of the issues which he seeks to present. Contrary to petitioner's assertion, the bankruptcy court did not expressly find

(Cont'd)

SUMMARY OF ARGUMENT

Neither of the questions presented by the petition merit this Court's review. With regard to the first, this Court long ago held that a written statement made "either with actual knowledge that it was incorrect, or with reckless indifference to the actual facts" was sufficient to deny the discharge of a debtor's obligations under the Bankruptcy Act of 1898. *Morimura, Arai & Co. v. Taback*, 279 U.S. 24, 33 (1929). As recently stated by this Court, the present Bankruptcy Code should not be read "to erode past bankruptcy practice absent a clear indication that Congress intended such a departure." *Pennsylvania Dept. of Public Welfare v. Davenport*, 495 U.S. 552, 563 (1990). Congress has never questioned the validity of *Morimura* and the Courts of Appeal have uniformly held that reckless indifference is sufficient to establish an intent to deceive under § 523(a)(2) and its predecessors. *See, e.g., Carini v. Matera*, 592 F.2d 378 (7th Cir. 1979); *In re Houtman*, 568 F.2d 651 (9th Cir. 1978); *David v. Annapolis Banking & Trust Co.*, 209 F.2d 343 (4th Cir. 1953). Thus the decision below equating reckless conduct with intent to deceive is completely harmonious with the Bankruptcy Code and the decisions of this Court and all other Courts of Appeal.

Similarly, with respect to the second question, the decision below of the Court of Appeals to apply the clearly erroneous

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(Cont'd)
that Dr. Woolum did not intend to deceive Bank One. Petition at 7. Rather, the bankruptcy court started from the premise that a debtor's reckless disregard of outstanding liabilities was sufficient to deny discharge and focused on whether Dr. Woolum's conduct was reckless. (A[p]32a — A[p]33a). Although the bankruptcy court's approach was entirely correct, in light of the district court's subsequent statement that "the record would easily support a finding of actual, deliberate intent to deceive" (A[p]19a), it appears that the decision below is correct without regard to the question of whether reckless disregard satisfies the intent element.

standard of review to the bankruptcy court's finding of reasonable reliance is consistent with the overwhelming weight of authority in the Courts of Appeal. *See, e.g., In re Lansford,* 822 F.2d 902 (9th Cir. 1987); *In re Collins,* 946 F.2d 815 (11th Cir. 1991). Although, in affirming a district court's finding of reasonable reliance, the Fifth Circuit once followed the *de novo* standard, the issue of the proper standard of review was not determinative and apparently not raised. *Matter of Jordan,* 927 F.2d 221 (5th Cir. 1991). Accordingly, subsequent Fifth Circuit opinions have not followed *Jordan's* statement regarding *de novo* review of reasonableness. Moreover, given the inherently factual nature of the concept of "reasonableness", *de novo* review of findings of reasonableness would run counter to this Court's rationale in *Anderson v. Bessemer City,* 470 U.S. 564 (1985). Simply stated, notwithstanding the number of bankruptcy cases filed each year, this Court's review of this question is unnecessary as there is nothing to add to this correct, fair and well established point of bankruptcy law. Indeed, any concern regarding the increasing volume of bankruptcy cases is itself a sufficient reason to reject petitioner's argument since *de novo* review of reasonableness findings would only impose further burdens on the district courts and courts of appeal.

REASONS FOR DENYING THE WRIT

I.

THE DECISION BELOW THAT RECKLESS DISREGARD FOR THE TRUTH CONSTITUTES INTENT TO DECEIVE UNDER SECTION 523(a)(2)(B)(iv) IS CONSISTENT WITH THE BANKRUPTCY CODE AND ALL DECISIONS OF THIS COURT AND THE CIRCUITS.

Guided by the established and uniform law of the Courts of Appeal, the bankruptcy court framed the issue as whether Dr. Woolum acted recklessly in omitting substantial guaranty

obligations from his financial statements and then found, based on the evidence, that Dr. Woolum had indeed acted grossly reckless. (A[p]32a - A[p]33a). The district court affirmed that reckless conduct satisfied the intent element and further found that "the record would easily support a finding of actual, deliberate intent to deceive," considering Dr. Woolum's education and business experience and particularly his failure to disclose the $388,000 Owens-Corning obligation after he had been sued on it. (A[p]18a - A[p]19a). The Court of Appeals, relying on its decision in *In re Martin*, 761 F.2d 1163 (6th Cir. 1985), affirmed and held that "gross recklessness is sufficient to establish an intent to deceive." (A[p]4a).

Petitioner seeks to have this Court overturn this established body of law because § 523(a)(2)(B)(iv) does not contain the word "reckless." Petitioner supports this request, without citation to a single decision regarding intent or reckless conduct, on the ground that the statute is plain on its face and that analysis of a bankruptcy section begins and ends with the language of the statute itself. In previously construing the Bankruptcy Code, however, this Court has warned "we must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy." *Kelly v. Robinson*, 479 U.S. 36, 43 (1986). Moreover, as stated by this Court, "[t]he normal rule of statutory construction is that if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific. (citation omitted). The Court has followed this rule with particular care in construing the scope of bankruptcy codifications." *Midlantic National Bank v. New Jersey Dept. of Environmental Protection*, 474 U.S. 494, 501 (1986).

When Congress enacted § 523(a)(2) of the Bankruptcy Code of 1978, the judicial practice of inferring intent to deceive from reckless disregard of the truth was well established in actions brought under the Bankruptcy Act of 1898 to deny a debtor's

discharge for use of false statements. In *Morimura, Arai & Co., v. Taback*, 279 U.S. 24 (1929), this Court construed a provision of the 1898 Act that completely barred discharge of all debts if the debtor had obtained property on credit by use of a materially false statement in writing. Under the 1898 Act, the term materially false connoted more than incorrectness and required intent on the part of the debtor. This Court held that such intent was established if the written statement "was made and acquiesced in either with actual knowledge that it was incorrect, or with reckless indifference to the actual facts, without examining the available source of knowledge which lay at hand, and with no reasonable ground to believe that it was in fact correct." *Morimura*, 279 U.S. at 33.

Similarly, prior to the enactment of § 523(a)(2), the Courts of Appeal had consistently held that reckless conduct was sufficient to establish an intent to deceive under its predecessor, § 17(a)(2) of the Bankruptcy Act.[3] For example, in reaching that conclusion, the Ninth Circuit analyzed *Morimura* and reasoned that requiring actual knowledge "would have the incongruous effect of imposing

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3. Section 17(a)(2) of the Bankruptcy Act provided in relevant part:

> (a) A discharge in bankruptcy shall release a bankrupt from all of his provable debts . . . except such as . . . .
>
> (2) are liabilities for obtaining money or property by false pretenses or false representations, or for obtaining money or property on credit or obtaining an extension or renewal of credit in reliance upon a materially false statement in writing respecting his financial condition made or published in any manner whatsoever with intent to deceive, or for willful malicious conversion of property of another.

Bankruptcy Act § 17(a)(2) (formerly codified at 11 U.S.C. § 35(a)(2)) (repealed 1978).

a stricter standard for exempting a single debt from discharge than formerly was required to completely bar discharge of all debts." *In re Houtman*, 568 F.2d 651, 656 (9th Cir. 1978). The Fourth Circuit held that reckless indifference was sufficient and affirmed the decision of the lower court denying discharge to a wife who allowed her husband to submit a false financial statement on her behalf without verifying its accuracy. *David v. Annapolis Banking & Trust Co.*, 209 F.2d 343 (4th Cir. 1953). The Seventh Circuit stated that where "a person knowingly or recklessly makes a false representation which the person knows or should know, will induce another to make a loan, intent to deceive may logically be inferred." *Carini v. Matera*, 592 F.2d 378, 380 (7th Cir. 1979). *Accord Matter of Bardwell*, 610 F.2d 228 (5th Cir. 1980); *Woolen Corporation of America v. Gitnig*, 33 F.2d 259 (3rd Cir. 1929).

There is no indication that Congress intended to alter this long standing bankruptcy practice when it enacted § 523(a)(2)(B). To the contrary, there is every reason to believe that Congress intended for the practice to continue. The legislative history notes that "[s]ection 523(a)(2)(B)(iv) is not intended to change from present law . . . ." 124 Cong. Rec. 32350, 32399 (statements of Rep. Don Edwards). Thus it is not surprising that, subsequent to the enactment of § 523(a)(2), Courts of Appeal still follow the cases construing the 1898 Act holding that reckless indifference of the truth is sufficient to bar discharge. *See, e.g., Birmingham Trust National Bank v. Case*, 755 F.2d 1474 (11th Cir. 1985); *Matter of Walker*, 726 F.2d 452 (8th Cir. 1984).

In sum, the Court of Appeals' decision on this issue is harmonious with the decisions of this Court and the other Circuits and, in light of this Court's instructions for construing the Bankruptcy Code, the petition does not present an issue of substantial importance warranting this Court's review.

II.

THE DECISION BELOW APPLYING THE CLEARLY ERRONEOUS STANDARD OF REVIEW TO THE BANKRUPTCY COURT'S FINDING OF REASONABLE RELIANCE IS CONSISTENT WITH THE OVERWHELMING WEIGHT OF AUTHORITY IN THE CIRCUITS.

After hearing all the testimony and reviewing all the evidence submitted during the hearing, the bankruptcy court found that Bank One reasonably relied on Dr. Woolum's materially false financial statements. On appeal, the district court conducted a second full scale review of the evidence and, after drawing its own inferences, reversed the bankruptcy court's finding of reasonable reliance. In order to reach that result, the district court concluded that it was entitled to conduct a *de novo* review of the bankruptcy court's finding based on *Matter of Lockard*, 884 F.2d 1171 (9th Cir. 1989), a case that did not involve a nondischargeability action. The Court of Appeals held that the district court committed reversible error in applying the *de novo* standard of review declaring that "[w]hether a creditor's reliance was reasonable is a factual determination to be made in light of the totality of the circumstances." (A[p]9a).

Petitioner requests review by this Court to resolve a perceived conflict arising from a Fifth Circuit opinion and to impose the *de novo* standard after necessarily ignoring the overwhelming authority among the Circuits and this Court's own holdings. Petitioner cites no cases involving a finding of reasonableness, but instead relies on various cases ascribing legal status to statutory terms such as "farming operation", "constructive trust", "fiduciary", and "substantial abuse."[4] Given the correctness of the

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4. Unlike the fundamental concept of reasonableness, these terms have no generally recognized meaning in the absence of their statutory definitions and judicial interpretations.

decision below, its accord with this Court's rationale in *Anderson v. Bessemer City*, 470 U.S. 564 (1985), and the practical insignificance of the Fifth Circuit's contrary statement, there is no important reason for review by this Court.

When squarely faced with the determinative question of whether a finding of reasonable reliance under § 523(a)(2)(B) is reviewable *de novo* or under the clearly erroneous standard, the Courts of Appeal have uniformly applied the clearly erroneous standard. For example, the Ninth Circuit held that "[w]hether the misrepresentations were material under the circumstances, whether there was reasonable reliance, and whether there was intent to deceive are issues of fact." *In re Lansford*, 822 F.2d 902, 904 (9th Cir. 1987). In reversing a contrary conclusion reached by a district court, the Seventh Circuit explained:

> This Court, however, has held that a bankruptcy court's determination of dischargeability is subject to a clearly erroneous standard of review. (citation omitted). Here, the bankruptcy court held two days of trial and was able to closely evaluate the witnesses' testimony. Absent an abuse of discretion, an appellate court should not attempt to redetermine credibility of witnesses.

Matter of Bonnett, 895 F.2d 1155, 1157 (7th Cir. 1990). The Tenth Circuit stated that the reasonableness of a creditor's reliance was a finding of fact to "be evaluated according to the particular facts and circumstances present in a given case." *In re Mullet*, 817 F.2d 677, 679 (10th Cir. 1987). *Accord In re Collins*, 946 F.2d 815 (11th Cir. 1991); *In re Ashley*, 903 F.2d 599 (9th Cir. 1990).

In an effort to create some glimmer of uncertainty in this well

settled area of the law, petitioner can offer only the case of *Matter of Jordan*, 927 F.2d 221 (5th Cir. 1991). There are numerous problems with the opinion in *Jordan* which undermine its status as conflicting authority or, at the very least, establish that whatever conflict it creates has no practical significance and does not require immediate resolution by this Court. First, it is unclear from the opinion whether the issue of the appropriate standard of review was raised in *Jordan*. In *Jordan*, the district court found that the creditor had reasonably relied on the debtor's financial statements. On appeal, the Fifth Circuit matter-of-factly announced that the finding was a conclusion of law, but it is unclear whether the creditor had argued any differently. Given that the Fifth Circuit affirmed the district court's finding, the application of the less deferential standard was not determinative of the outcome in the case.

Second, the two cases relied on by the Fifth Circuit did not support its holding. One of the cases, *In re Bonnett*, 73 B.R. 715 (C.D. Ill. 1987), had already been reversed on appeal by the Seventh Circuit in *Matter of Bonnett*, 895 F.2d 1155 (7th Cir. 1989). The other citation, *In re Martz*, 88 B.R. 663 (Bankr. E.D. Pa. 1988), is a bankruptcy court decision which did not involve an issue of appellate review and never mentioned the clearly erroneous or the *de novo* standard.

Third, subsequent Fifth Circuit cases appear to apply the clearly erroneous standard to review of reasonableness findings despite *Jordan's* contrary statement of law. For example, in *Matter of Luce*, 960 F.2d 1277 (5th Cir. 1992), the Fifth Circuit cited *Jordan* for the general proposition that findings of fact are reviewable under the clearly erroneous standard and conclusions of law are reviewable *de novo*. The court then stated, however, that "[s]ince '[d]eterminations as to the dischargeability of debts under section 523 are reviewed under the clearly erroneous standard,' we subject only the bankruptcy court's conclusions as to attorney's fees to *de novo* review." *Luce*, 960 F.2d at 1280.

Finally, the Fifth Circuit itself appears to have questions regarding the merits of *Jordan's* invasion of the bankruptcy court's fact finding role. In *Matter of Coston*, 977 F.2d 175, 180 (5th Cir. 1992), *reh'g en banc granted*, 980 F.2d 1513 (5th Cir. 1993), the Fifth Circuit, in an admitted "close call", reversed the decisions of the two lower courts solely on the issue of reasonable reliance, and, in so doing, followed its decision in *Jordan*.

A majority of the judges on the Fifth Circuit have since voted in favor of granting a rehearing *en banc*, withdrawing the opinion in *Coston* — the only apparent issue for decision being the continued prudence of its lonely stance in *Jordan*. *Matter of Coston*, 980 F.2d 1513 (5th Cir. 1993). Thus the illusory and insignificant split relied on by Dr. Woolum stands ready to be corrected in the forum of its creation, leaving nothing to necessitate review by this Court.

III.

THE COURT OF APPEALS' DECISION THAT A FINDING OF REASONABLE RELIANCE IS A FINDING OF FACT SUBJECT TO THE CLEARLY ERRONEOUS STANDARD OF REVIEW IS CONSISTENT WITH THE DECISIONS OF THIS COURT.

This Court early on recognized the inherent factual nature of a finding of reasonableness. In construing a bankruptcy statute that conditioned avoidance of a transfer of property on a finding that the person receiving it had "reasonable cause to believe that it was intended thereby to give a preference," this Court held that "[w]hether such 'reasonable cause to believe' existed is a question of fact." *Pyle v. Texas Transport & Terminal Co.*, 238 U.S. 90, 98 (1915).

In the case below, the district court's disagreement with the bankruptcy court's finding of reasonable reliance turned not so

much on legal points as on disputed facts and inferences. For example, the district court disputed Bank One's reliance on an unsigned financial statement, yet ignored the evidence that Dr. Woolum acknowledged to Bank One that the unsigned statement was his and submitted for the same purpose as a signed one. The district court found that a nine month old statement could not be relied on, but glossed over Bank One's testimony that the bank customarily relied on financial statements for up to one year. Although the undisputed evidence in the record established that neither local banks nor Bank One would customarily notify their loan officers when a garnishment was attempted against someone who had no accounts with the bank, the district court found that the garnishment clerk should have notified Rumpke and that it was unreasonable for Rumpke not to check other branches and departments of the bank for garnishments before making a loan. In essence, the district court substituted its own business judgment for that of Bank One.

This case illustrates that anytime there is evidence on both sides of an issue one fact finder may always reach a different conclusion than the other. It is for this reason that the clearly erroneous standard is mandated for review of factual findings. As this Court explained:

> The rationale for deference to the original finder of fact is not limited to the superiority of the trial judge's position to make determinations of credibility. The trial judge's major role is the determination of fact, and with experience in fulfilling that role comes expertise. Duplication of the trial judge's efforts in the court of appeals would very likely contribute only negligibly to the accuracy of fact determination at a huge cost in diversion of judicial resources. In addition, the parties to a

> case on appeal have already been forced to concentrate their energies and resources on persuading the trial judge that their account of the facts is the correct one; requiring them to persuade three more judges at the appellate level is requiring too much.

Anderson v. Bessemer City, 470 U.S. 564, 574-75 (1985).

As a result of its inherent factual nature, there could never be a general rule or touchstone as to what constitutes reasonable reliance. What is reasonable depends on a potentially endless array of variables which can only be evaluated as each case arises. Thus there is simply no reason to expend the valuable time of an appellate court in reviewing the bankruptcy court's finding on this issue. As noted above, subsequent review of such a finding would not likely increase its accuracy, yet would divert the valuable resources of the court and the parties.

CONCLUSION

For the foregoing reasons, the Petition for Writ of Certiorari should be denied.

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